BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of ROBERT A. GOODIN; AND ESTATE OF THOR F. WILCOX (DECEASED) AND MARJORIE C. WILCOX	))))))	No. 86A-0294-MA 86A-0297

For Appellant: Curtis W. Berner
Attorney at Law

For Respondent: Lazaro L. Bobiles
Counsel

O P I N I O N

These appeals are made pursuant to section 18593[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Robert A. Goodin against a praposed assessment of additional personal income tax in the amount of $869 for the year 1979, and on the protest of the Estate of Thor F. Wilcox (deceased) and Marjorie C. Wilcox against a proposed assessment of additional personal income tax in the amount of $467 for the year 1979.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

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The issue in these consolidated appeals is whether appellants are entitled to claimed partnership loss deductions.

These appeals involve two partners in the San Francisco law firm of Armour, St. John, Wilcox, and Goodin. In 1979, one of appellants' partners, Mr. Armour, received an assignment of a portion of the general partnership interest in an oil and gas extraction partnership known as MR 79 as compensation for his legal services. Specifically, pursuant to an agreement dated June 1, 1979, the two general partners in MR 79 assigned Armour five percent of the allocations and compensation owed them as general partners in MR 79. The agreement specifically provided that Armour was not to be construed as a general partner in MR 79.

Subsequently. Armour assigned his interest in MR 79 to a general partnership called GWSA 79. GWSA 79 was comprised of Armour and his other law partners, including appellants. The purpose of GWSA 79 was to hold the interest in and receive distributions from the MR 79 partnership. None of the four partners made any capital contributions to the GWSA 79 general partnership or devoted any time to the business of the partnership.

For 1979, MR 79 assigned $31,495 of its losses to GWSA 79 which the latter reported as its partnership loss for the year. The partners in GWSA 79 were each allocated 25 percent, or $7,874, of this loss, On their personal tax returns, appellants each claimed this amount as a partnership loss deduction.

Respondent disallowed the claimed deductions on the grounds that GWSA 79 did not have a general partnership interest in MR 79. It argues that Armour was merely assigned profits or losses in MR 79, and, since he was not a general partner, there was no partnership basis in MR 79 which could then be allocated ta GWSA 79 and appellants.

It is well settled that deductions are a matter of legislative grace, and the burden is on the taxpayer to show entitlement thereto. (New Colonial Ice Co, v. Helvering 292 U.S. 435 [78 L.Ed. 1348-1 (1934); Appeal of Ambrose L. and Alice M. Gordos, Cal. St. Bd. of Equal., Mar. 31, 1982.) In order to establish that they are entitled to their claimed deductions, appellants must-show that GWSA 79 received a general partnership interest in MR 79 or that Armour became a *substituted partner" in MB 79 and assigned this status to GWSA. (See Hamilton, et al. v. United States, 687 F.2d 408, 415 (Ct. Cl. 1982); Rev. Rul. 77-137, 1977-1 Cum. Bull. 178.)

Appellants have conceded that, under the provisions of California Corporations Code section 15027, Armour's interest in MR 79 was not a general partnership interest. Rather, they argue that under Revenue Ruling 77-137, supra, Armour (and, in turn, GWSA 79) should be treated as a "substituted partner" in MR 79 entitled to claim the deductions in question.

Respondent takes the position that the present factual situation differs from that in Revenue Ruling 77-137 in that Armour did not acquire dominion and control over the MR 79 limited partnership. Respondent argues that unless GWSA 79 acquired substantially all of the dominion and control over the five percent partnership interest assigned to Armour by the general partners of MR 79, Revenue Ruling 77-137 cannot apply.

In Revenue Ruling 77-137, a limited partner assigned his entire interest to another. The assignee did not become a substituted limited partner but was a mere assignee. Under the terms of the assignment, the assignor (who under local law remained the nominal limited partner) agreed to exercise any residual powers solely in favor of and in the interest of the assignee. The Internal Revenue Service held that the assignee was a substituted limited partner for income tax purposes even though he was not a substituted limited partner for purposes of local law.

Unlike the parties in Revenue Ruling 77-137, the MR 79 general partners did not give up any incidents of ownership when they assigned a portion of their partnership interest to Armour. Instead, the general partners merely assigned a portion of the financial benefits and burdens accruing to them under the partnership agreement.

It is well settled that a partner in an operating partnership may assign a portion of his interest to another and thereby create a "subpartnership" with respect to the interest assigned even though the assignee is not admitted to the operating partnership and does not have dominion and control. (Bayou Verret Land Co. v. Commissioner, 450 F.2d 850 (5th Cir. 1971.) The question which remains is whether such an assignment results in the assignees being treated as substituted partners for tax purposes. We think not. In this case the assignment merely results in an assignment of the profits and losses of the partnership as a means of compensation for Armour's legal services. The assignees were lacking the requisite dominion and control to be considered substituted partners. While appellants argue, on the one hand, that dominion and control are not a controlling factor, and then, on the other hand, that dominion and control were present by virtue of

the fiduciary responsibilities of the assignors to the assignees, the fact remains that the assignment did not transfer any incidents of ownership. For that reason, Revenue Ruling 77-137 is clearly not applicable to the facts of this case. It is well settled that a mere sharing in profits (or losses) does not justify an inference of partnership. (See Appeal of Henry E. and Marjorie E. Wohler, Cal. St. Bd. of Equal., June 25, 1985.)

The parties' arguments with regard to whether or not the assignors claimed deductions for the assigned portion of the losses do not aid the resolution of this appeal. Even if a "double deduction" did not occur, that has no effect on our finding that appellants were not entitled to claim the deductions in question.

For the foregoing reasons, respondent's action in these matters will be sustained in all respects.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Robert A. Goodin against a proposed assessment of additional personal income tax in the amount of $869 for the year 1979, and on the protest of Estate of Thor F. Wilcox (deceased) and Marjorie C. Wilcox against a proposed assessment of additional personal income tax in the amount of $467 for the year 1979, be and the same is hereby sustained.

Done at Sacramento, California, this 2nd day of June, 1989, by the State Board of Equalization, with Board Members Mr. Carpenter, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Davies present.

Paul Carpenter, Chairman

Conway H. Collis, Member

William M. Bennett, Member

Ernest J. Dronenburg, Jr., Member

John Davies*, Member

*For Gray Davis, per Government Code section 7.9